Financial Markets

Irving Trust

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Economic Research &
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Friday
(Noon)

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There has been considerable discussion lately about the implications of changes in Federal Reserve operating procedures--i.e., the guidelines the Domestic Desk at the Federal Reserve Bank of New York follows in implementing the Federal Open Market Committee's targets for monetary growth. It appears that the recent history of Fed operating procedures can be divided into three general phases. Under the "old" procedures reserves were supplied in order to keep the Federal funds rate close to the target rate. Detecting shifts in the Fed's target rates was a simple matter of watching the Fed's so-called intervention points.

The "new" procedures were introduced on October 6, 1979 ("the Saturday night special"). In essence, they involved supplying nonborrowed reserves along a path thought to be consistent with the monetary aggregates targets, though the short-run path could be--and often was--shifted to speed the adjustment of money growth to target. The difference between banks' required reserves and the volume of nonborrowed reserves is net borrowed reserves (discount window borrowings less excess reserves). Thus if the Fed moved to slow the provision of nonborrowed reserves, the initial result would be an increase in borrowing, together with an increase in the funds rate. The key difference between the "old" and "new" procedures was thus the faster speed of adjustment of the funds rate--a Committee vote was no longer necessary to move it! Nevertheless, the FOMC was sensitive to fears of the unstabilizing effects of a volatile funds rate and restricted the allowable variation of the rate within a band of several percentage points. However, in the latter part of 1980, the band had to be moved up frequently as the funds rate soared. Finally, toward the end of the year, the FOMC--perhaps less apprehensive now of funds rate volatility--simply granted the Desk "leeway" to allow the rate to go its merry way.

In retrospect, this probably marked the end of the "new" procedures and the genesis of the "new-new" procedures, which market participants currently are trying to understand. Now, the constraint on the Federal funds rate is more apparent than real: it must appear to be inconsistent with the reserves path "over a period of time" before the Desk requests further guidance. Hence the band really serves as a kind of trigger device for FOMC telephone conference calls.

Obviously rate-watching is largely finished as a guide to the Fed's policy stance. In principle, one could track the growth of nonborrowed reserves, but uncertainties due to seasonal adjustments, shifts between deposit types, etc., make that approach difficult (a fact not always appreciated by analysts). Though it has its faults, the best indicator--aside from detailed analysis of open market operations--is probably net borrowed reserves, since it is the discrepancy between banks' required reserves and the amount of reserves the Fed is willing to supply through open market operations. (For the record, net borrowed reserves have risen from about $600 million in the first half of March to about $800 million in the two weeks ending April 8, possibly indicating a slight tightening.)

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

Irving Trust

Market Yields

	4/17/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	17.00%	17.00%	19.50%
Effective since	4/1/81		
Discount Rate at Federal Reserve Bank	13.00	13.00	13.00
Federal Funds	15.00	15.50	18.50
Repurchase Agreements	14.75	15.25	16.00
U.S. Treasury Issues			
Bills			
3 months	14.38	14.28	14.20
6 months	14.73	14.50	13.70
1 year	14.35	14.00	13.00
Coupons			
2 years	14.12	13.85	12.40
4 years	14.05	13.85	11.90
7 years	13.91	13.67	11.26
10 years	13.77	13.53	11.33
Long Bond	13.31	13.10	11.16
Negotiable Certificates of Deposit-Secondary Market			
1 month	15.30	15.00	16.75
3 months	15.50	15.10	16.30
6 months	15.55	15.15	17.65
1 year	15.60	15.00	NA
Banker's Acceptances			
1 month	15.10	15.00	16.60
3 months	15.00	15.18	16.55
6 months	14.40	14.95	15.40
Eurodollar Deposits			
1 month	15.88	15.81	17.69
2 months	16.13	15.88	17.63
3 months	16.44	15.88	17.44
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	14.50	14.75	12.00
1 month	14.25	14.00	15.00
3 months	14.00	13.00	13.00
Bank Holding Companies			
1 month	15.00	14.75	15.75
Dealer Placed:			
3 months	NA	14.75	15.80
New AA Corporate Utility Bond	15.65	15.55	14.25
Tax Exempt			
6 month Project Notes	7.30	6.50	6.75
1 year AAA Bond	7.40	7.20	6.50
5 year AAA Bond	8.25	8.40	6.50
20 year AAA Bond	10.25	9.70	7.30

This information represents prevailing market yields.

It should not be construed as an offering.

All yields are on the offered side of the market.

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